

New SEC Short Sale Rule Extends and Modifies Emergency Orders

Earlier this week, the Securities and Exchange Commission (SEC) adopted new Rule 10a-3T, extending and modifying short sale reporting rules established by the SEC's Emergency Orders dated September 18, 2008, September 21, 2008 and October 2, 2008. Rule 10a-3T is an interim final temporary rule that is effective immediately and will expire August 1, 2009. A summary of key provisions of the new rule and its adopting release follows.

Key Modifications

- **Reporting Deadline.** The reporting deadline has been moved from the first business day following a calendar week in which short sales are effected to the *last business day following a calendar week in which short sales are effected*. The first Form SH report under the rule is due October 24, 2008.
- **Reporting Requirements.** Beginning October 24 (with respect to short sales made and short positions held the week of October 13-19), Form SH filers will be required to report *all short positions in section 13(f) securities* (other than positions below the minimum reporting thresholds described below) for any week in which the filer effects *any reportable short sale* in a section 13(f) security. For example, if a manager has 19 existing short positions at the beginning of a week, whether or not previously reported on Form SH, and during the week the manager enters into a single new reportable short sale, the manager must file a new Form SH for that week reporting on each of its 20 short positions.
- **Reporting Thresholds.** The SEC's Emergency Orders had exempted Form SH filers from reporting short sales or positions that represented less than 0.25 percent of a class of an issuer's securities and had a fair market value of less than \$1 million. Except as described below with respect to the transition rule for reports filed October 24 and October 31, the dollar threshold for reporting short sales or positions has been raised from \$1 million to \$10 million (the 0.25 percent threshold is unchanged).
- **Reporting on Pre-September 22, 2008 Positions.** Beginning October 24, and subject to the transition rules described below, Form SH filers will be required to report all short positions (other than positions below the minimum reporting thresholds), *including short positions entered into prior to September 22, 2008*, when reporting data elements 5, 6 and 7, Short Position (Start of Day), Number of Securities Sold Short (Day) and Short Position (End of Day) on Form SH.
- **Transition Rules.** The adopting release for Rule 10a-3T includes transition rules for the reporting of positions entered into prior to September 22. These transition rules only apply to reports due October 24 and October 31. The rules are stated in several different ways in the release, and appear open to at least two interpretations. First, the transition rules may be read as permitting filers to exclude all pre-September 22 short positions from reports filed during the transition period, so long as the filers report positions entered into on or after September 22 subject to a \$1 million reporting threshold (rather than the \$10 million threshold otherwise applicable under the new rule). Alternatively, the transition rules may be read as requiring all filers to report pre-September 22 short positions during the transition period if, with respect to any such position, the position had a fair market value of at least \$1 million on September 22 or represented not less than 0.25 percent of the outstanding shares of such security and the filer is otherwise required to file a Form SH during the transition period. The SEC has acknowledged, in conversations with Ropes & Gray, that the transition rules are open to multiple interpretations, and has indicated that the staff will be meeting next week to clarify the application of these rules. We are hopeful that the SEC will adopt the first, more logically consistent, interpretation of the rules.

- **Aggregate Gross Short Sales.** For purposes of Rule 10a-3T, a short position is the aggregate gross short sales of an issuer's section 13(f) securities (excluding options), less purchases to close out a short sale in the same issuer. *A manager's Form SH short position is not net of the manager's long position in the same security.*
- **XML Submission and Formatting.** Filers will be required to submit an XML tagged data file to the SEC providing the requested data in Form SH. For reports due October 24 and October 31 only, filers do not have to file Form SH in XML format and may continue to file on EDGAR as they have done under the emergency orders. Rule 10a-3T also requires filers to format Form SH data differently than under the emergency orders.
- **Reported Short Positions.** Form SH filers will no longer be required to disclose the value of the securities sold short (currently column 5 of Form SH), the largest intraday short position (currently column 7) and the time of day of the largest intraday short positions (currently column 8).

Key Provisions Retained from Emergency Orders

- **No Filing in the Absence of Reportable Short Sales.** There is no need to make a Form SH filing if there have been no reportable short trades during the reporting period.
- **Nonpublic Filing.** Form SH filings will continue to be made on a nonpublic basis to the extent permitted by law and should continue to be marked **NONPUBLIC**.
 - The release notes that the Freedom of Information Act (FOIA) provides at least two exemptions under which the Commission has authority to withhold the information. However, a FOIA request for the information could still be made. If you are notified that a FOIA request has been made, it is important that you contact counsel immediately so that you do not risk waiving any of your procedural rights under FOIA.
- **Staff Guidance.** To the extent still relevant, the staff guidance pursuant to the emergency orders regarding reporting short sales and positions on Form SH was carried forward to the interim final temporary rule.

Noteworthy Comments Requested

The SEC requested comments on many aspects of the temporary rule. Interested parties have 60 days to comment on the proposed rule.

- **Synthetic Shorting.** The SEC has requested comment on whether it should require disclosure of short sales through synthetic instruments or through third parties that are not required to report on Form SH, or whether it should require any short seller that is entering the short to hedge a synthetic position entered into with another party to identify the other party in Form SH. Synthetic shorts are not currently required to be reported on Form SH, but the request for comment makes clear that the SEC is continuing to evaluate the merits of requiring such disclosure. In the meantime, clients should exercise caution to avoid any perception that a synthetic position was entered into in order to evade reporting.
- **Nonpublic Filing.** The SEC is still considering whether reports should be nonpublic, and if not, whether there would be a reasonable time period after which disclosure to the public would be appropriate, e.g., 10 days or 45 days after the end of a quarter in which the transaction occurred.
- **Timing of Filing.** The SEC requested comment on the timing of the filings, i.e., should they be required daily, weekly, bi-weekly, monthly or quarterly.

Contact Information

If you would like to learn more about the issues raised in this update, please contact your Ropes & Gray adviser.

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